**Opening statement**
**Budget of the Securities and Futures Commission 2017/18**
**at the**
**meeting of the Panel on Financial Affairs**
**Legislative Council**

**Carlson Tong**
**Chairman**
**Securities and Futures Commission**

**6 February 2017**

Honourable Chairman
Honourable Members of the Panel on Financial Affairs

1. It is my pleasure to present the SFC's Budget for the year 2017/18 to you. I'll start by highlighting a few key components of our Budget. I'll then outline our underlying philosophy for resource allocation and comment on some current issues affecting the quality of our securities market. Core to our budget exercise is long-term sustainability that will enable the SFC to effectively deliver on its statutory objectives and operational priorities.

2. The SFC is expected to be running budget deficits from the fiscal year 2016/17 onwards unless future securities market turnover increases significantly from its current level. For 2016/17, the forecast deficit is $507 million, which is $109 million over the budget deficit of $398 million, mainly due to a lower than expected levy income. Our Budget had assumed the average securities market daily turnover to be $87 billion, which is now adjusted downward to $71 billion in our forecast for the year. The turnover of the securities market is one of the key drivers of the SFC's income. The unpredictable and volatile nature of the market turnover component presents an unavoidable degree of uncertainty in the annual budget exercise. Based on an assumed daily turnover of $81 billion, we project that the budget deficit for 2017/18 will be $534 million.

3. At the end of the 2016/17 fiscal year, the SFC's reserves will stand at $6.77 billion, including $3 billion set aside and ringfenced for property acquisition. With a $534 million budget deficit, the 2017/18 fiscal year will end with the reserves falling to $6.236 billion, or approximately 3.2 times of our annual expenditure.

4. We attach great importance to prudent management of our reserves, guided by the goal of long-term financial sustainability. We have carefully considered and taken on board the suggestion to be prepared financially for purchasing our own office premises, by setting aside and ringfencing $3 billion for when a suitable opportunity arises to acquire property to house our operations. The two consecutive budget deficits in 2016/17 and 2017/18 will mean that our reserves will further contract, projected to be reduced to about two times of our annual expenditure in another four to five years.

5. We have assessed the effect of the licensing fee holiday which has been in place since April 2012, as well as the reductions in levy rate. The licensing fee holiday is a measure that brings a certain degree of financial relief to licensed intermediaries, especially smaller firms. This translates into a foregone annual licensing fee income of $192 million. However, the levy rate has far greater impact on the SFC's income. In view of a very significant accumulation of reserves around a decade ago, the SFC has made three reductions in the levy rate. Coupled with more subdued market turnover in recent years, the current levy rate of 0.0027% will mean that, unless turnover increases significantly from current levels, the SFC will run a budget deficit and need to draw on its reserves to fund its operational needs. I should point out that had we not made the three levy reductions, which nearly halved the levy rate, the SFC would have been able to run a balanced budget. Obviously, running a deficit budget is not a sustainable arrangement in the longer run. Without a significant increase in market turnover, it may be necessary to re-assess the levy rate in future years.

6. Now let me turn to the SFC's priorities. A principal SFC objective is to contribute to the healthy development of Hong Kong as an IFC. We have recently spearheaded some important initiatives to enhance

Hong Kong's role as a lynchpin between global and Mainland markets. Last year, we saw the implementation of Shenzhen Connect, after Shanghai Connect has been operating smoothly for two years. Our mutual recognition of funds programme entered a new era in 2015 when it was extended to the Mainland following intensive negotiations between the SFC and CSRC. It has most recently been extended to Switzerland. This was a pioneering initiative whereby, for the first time, home-grown Hong Kong funds can gain direct access to sell to the investing public in a European market. We are now in discussions to extend this idea to other large European markets.

7. Our influence in the international regulatory community, in particular through CEO Mr Ashley Alder's election as Chairman of the IOSCO Board, has contributed hugely to Hong Kong's reputation as a leading global standard setter, as noted in a recent IMF report. This active role in international decision making ensures that Hong Kong's and Asia's views are heard loud and clear when the regulatory agenda is set for our globalised financial market.

8. Investor protection is at the heart of the SFC's work. Whether through supervision of firms, enforcement against misconduct, or our current emphasis on the quality of the listing market, we have a proven track record as an organisation which makes sure that the public interest is paramount. This investor protection focus is a vital component of our mission to develop Hong Kong as an IFC because the confidence of retail and international institutional investors in a sound regulatory system is essential for our markets to thrive in an increasingly competitive world.

9. The recent extreme share price volatility in newly listed GEM stocks is just one example of problems that are affecting our listed market. Make no mistake: local and international media coverage and commentaries on this issue as well as instances of misconduct involving Main Board as well as GEM companies has led to real reputational damage for these markets. And we have taken action. Most recently, the SFC issued guidelines concerning the expected behaviour of intermediaries when placing shares in GEM IPOs.

10. However this, together with a simultaneous joint statement about placings made by us together with HKEX, are not enough. There is no doubt that more needs to be done so that investors regain confidence in our listed market. The SFC is working with HKEX on a review of the operation of GEM. We are also working with HKEX on other regulatory issues to address wider market quality concerns, to promote market development whilst also protecting the public interest.

11. Finally, I should say something about the SFC and HKEX's joint consultation on the structure of listing regulation. We have received a very large number of submissions expressing an extremely wide range of views. This is an important and complex subject, and we are pleased that the public has taken such a keen interest in the regulation of a market which is vital to Hong Kong's overall position as an IFC. Many submissions both supporting and opposing the proposals were most constructive and will be very helpful as we consider the best way forward. They will of course need to be analysed carefully, and we will brief the Panel in more detail in a later meeting.

12. Getting back to our Budget, let me reassure you that we stick to a very disciplined approach when deciding on anticipated expenditure. First we ask ourselves what resources are needed in order to achieve the specific regulatory priorities we have set for the year and fulfil our statutory objectives. In the process, we make prudent assumptions, exercise robust financial control, and look for areas where we can re-deploy existing resources. The level of reserves that the SFC holds does not come into play in making these decisions.

13. This year, we have again proposed a moderate headcount adjustment of three percent, in line with 2016/17. The 28 new positions to be created will be deployed in six different Divisions. The additions are necessary to support the increased complexity and volume of enforcement and legal actions, and to cope with the continued growth of regulated activities conducted by licensed corporations, as well as the sheer number of licensees. There was significant and necessary growth in headcount between 2010 and 2015. However we remain of the view expressed last year that the SFC is just about the right size,

hence the relatively small headcount increase. We have also set out to strategically review our operations and leverage technology to increase efficiency without incurring additional staffing costs. For example, our Enforcement Division has recently adopted a new organisational structure around specialised teams and clear priorities.

14. Last but not least, we have therefore proposed that we maintain the levy at the current rate of 0.0027% and the licensing fee holiday to continue for the year 2017/18.

15. I hope I have provided Honourable Members a clear picture of how we manage and allocate our financial resources to enable the SFC to continue to act as an effective and efficiency regulator. Mr Alder and I will be happy to address questions from Members. Thank you.

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